

Reflections on Boundaries: A Reply to Charles Reich

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No tenet of American political ideology is clung to more tenaciously than is the idea that private and public sectors of our economy are, and should forever be, strictly separated. It is widely acknowledged, of course, that political choices *shape* markets; but so long as these interventions do not discriminate among particular outcomes or players, they do not violate the integrity of either domain. The “free market,” in this view, occupies one sphere of social activity; “politics,” another. Government occasionally intervenes in the market to favor particular groups, but these boundary crossings are exceptions to the general rule of neutrality. They should be carefully controlled and monitored, lest the borderline become blurred. This concern with the integrity of public-private borders is not the exclusive province of those on the right of the political spectrum, who forever fret about involuntary redistributions of wealth. Many who style themselves liberals and leftists also seek a strict demarcation. Their spectre is an alliance of large corporations and government agencies that would conspire against the rest of us.

I do not want to suggest that these concerns are unimportant, or without bases in history. Our collective experience during the post-war era confirms, to an extent, warnings from both the theorists of “democratic overload”¹ and the prophets of a “military-industrial state.”² And I sleep better at night knowing that the likes of Milton Friedman and Charles Reich are on the barricades, forever vigilant. Separating what is “public” from what is “private,” what is appropriately the responsibility of “government” from what we wish to assign to the “market,” moreover, can be a useful exercise to the extent that it forces us to examine how our social life is now organized, and how it could be organized differently. It also can help reveal deeper understandings and assumptions about the relationship between our “deontological” selves and our

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1. *E.g.*, Huntington, *The United States*, in *THE CRISIS OF DEMOCRACY: REPORT ON THE GOVERNABILITY OF DEMOCRACIES TO THE TRILATERAL COMMISSION* 59-118 (1975).

2. *E.g.*, D. Eisenhower, Farewell Radio and Television Address to the American People, 1960-61 PUB. PAPERS 1035, 1038 (January 17, 1961); C. WRIGHT MILLS, *THE POWER ELITE* 171-224 (1956).

social context.³ But a preoccupation with the sanctity of private-public borders can be distracting as well. It can distract us from examining the subtle ways in which such borders are inevitably permeable, and the important choices available to us in dealing with the resulting interpenetration.

This is not the occasion for a prolonged exegesis on the ideology of public-private boundaries, nor for a detailed discussion of how the recent debate over United States industrial policy has served to illuminate (or obscure) these boundary disputes. But Charles Reich's thoughtful response to some of my recent writing prompts me to fire off a few flares which, I hope, will shed a bit of light on this dark and contested terrain.

I. *The Problem of Legitimacy*

Charles Reich seems to have two basic worries about what he perceives to be my inordinate disrespect for public-private boundaries. The first has to do with government legitimacy. He frets that "[i]ndustrial policy would put government in the position of giving substantial benefits to some companies but not to others. . . . Inevitably government would thereby lose some of the neutrality needed to govern."⁴

But Charles Reich confuses prescriptions with descriptions. Government already provides substantial benefits to some companies but not to others. Consider, for example, the sharp disparities in the effective rate of corporate income tax paid by various industries in 1981 (see Exhibit 1).⁵ The industries with the lowest effective tax rate, interestingly, are either service industries largely sheltered from international competition (such as retailing, finance, airlines, utilities, commercial banks, and railroads), or natural-resource industries (oil and oil refining, petrochemicals, crude oil, and paper and wood products). Aerospace and metal manufacturing also fare relatively well. On the other hand, manufacturers of automobiles, trucks, pharmaceuticals, appliances, and electronics bear a relatively high effective tax.

Consider another set of disparities—the percentage of industrial research and development funded by the federal government (see Exhibit 2). (This sample is from 1977, the most recent year for which data are available.) Here the allocation of winners and losers is somewhat different. Aerospace again is among the winners, and automobiles

3. M. SANDEL, *LIBERALISM AND THE LIMITS OF JUSTICE* (1983).

4. C. Reich, *Conflicts Ahead on "The Next American Frontier"*, 2 YALE L. & POL'Y REV. 191, 196 (1984).

5. Except as otherwise noted, the following seven paragraphs and accompanying exhibits are adapted from R. Reich, *An Industrial Policy of the Right*, THE PUBLIC INTEREST, Fall 1983, at 3, 4-7.

Exhibit I.
Effective Rates of Corporate Income Tax

Automobiles	48%	Airlines	16%
Trucking	46%	Metal manufacturing	10%
Pharmaceuticals	36%	Utilities	9%
Electronics, appliances	29%	Aerospace	7%
Food processing	27%	Petrochemicals	5%
Industrial & farm equipment	24%	Crude oil	3%
Retailing	23%	Commercial banks	2%
Oil and refining	19%	Railroads	(8)%
Diversified financial	17%	Paper and wood	(14)%

Source: Joint Committee on Taxation, *Taxation of Banks and Thrift Institutions*, March 9, 1983, Table 2. (There are a number of ways to compute effective tax rates, and some computations generate results slightly different from these; but, regardless of methodology, great disparities exist.)

Exhibit II.
Percentage of R&D funded by the Federal Government

Aircraft and parts	70%	Motor vehicles	8%
Transportation equipment (excludes autos)	55%	Nonelectrical machinery	7%
Fabricated metals	53%	Petrochemicals	2%
Communications equipment, electronic components	49%	Primary metals	2%
Electrical equipment (excludes communications)	26%	Drugs and medicines	<1%
Scientific instruments	22%	Textiles and apparel	<1%

Source: National Science Board, *Science Indicators, 1978*, Washington, DC, 1979.

and pharmaceuticals among the losers. But the petrochemical industry now becomes something of a loser, while electrical equipment moves into the winner's camp. Nor does the distribution of research and development subsidies reveal the same bias against internationally-traded manufacturing industries as does the effective tax rate.

This inventory could go on, including virtually every area of government activity. In the cases of the federally-subsidized loans (amounting to some \$56 billion in new loans to specific industries in 1982) and loan guarantees (\$36 billion), the biggest winners by far are housing construction and agriculture, with aerospace and aircraft equipment coming in a distant third. On the other hand, the major industrial beneficiaries of import restrictions are steel, textiles, apparel, and automobiles (together comprising approximately one-fourth of all U.S. merchandise imports). And the Federal government obligingly purchases most of the output of the firms that produce aircraft, communications equipment, super computers and lasers.

Not surprisingly, the overall pattern of "winners" and "losers" conforms to no obvious criteria of public welfare. For example, the U.S. automobile industry (on which one out of every six American workers directly or indirectly depended for a livelihood in 1980) owes its present condition, at least in part, to a mixture of generous import restrictions and loan guarantees, onerous environmental regulations, relatively high effective tax rates, and little or no government-supported research. On the other hand, the housing-construction industry has been the indirect beneficiary of large credit and tax subsidies to American homeowners, the cumulative effect of which has been to help channel approximately one-third of U.S. gross domestic fixed investment over the last dozen years into housing and to transform the housing stock into a form of savings for countless middle-class families. The Federal government spends almost five times more money on research and development for commercial fisheries than it does for steel. As of 1980, the government was providing \$455 million annually in tax breaks for timber and none for semiconductors. And the fact that substantial benefits go to industries sheltered from international competition notwithstanding, some of the chief recipients of government largesse—like aircraft, communications equipment, electronic components, wheat and soybeans—are among the nation's most successful exporters.

Charles Reich concedes that government already engages in some allocation, and that industrial policy would give coherence to actions that are now incoherent. "But," he warns, "purposeful discrimination may more readily lead to challenge than do those policies that are merely

chaotic.”⁶

Are the discriminations I have described “merely chaotic”? Are they *unintentional*? They certainly look that way. They appear to be nothing but the fallout from separate government programs designed to achieve all manner of things—ensure national security, provide Americans with decent housing, protect domestic energy supplies, and so on. The programs were not officially intended to advance or retard the development of specific industries and companies. No one picked the winners and losers. They seem to have been anointed inadvertently.

But closer inspection reveals a not-so-well-kept secret. What looks like inadvertence is actually the product of careful strategy on the part of many companies, trade associations and their lobbyists and lawyers, and not a few sophisticated members of Congress and the Executive branch. True, the official language appearing in the *Congressional Record* and in administrative rulings—justifying this or that tax credit, loan guarantee, or research subsidy—typically makes at least passing reference to the public interest. It would be unseemly not to. And all but the most confirmed cynics would concede that many of these programs do benefit broad segments of the public. After all, we do want an effective national defense and affordable housing. But the fact is that these public benefits are often incidental to the choice of what industry or company actually comes out the winner. Those who promote and shape public policy in America usually know fairly well how a given policy will affect the development of a specific industry or company. Indeed, such a purpose often lies at the very heart of the initiative, encased within layers of public justifications bearing no direct relation to it. And more often than not, the most heated legislative and administrative battles concern not the wisdom of the policy itself but the underlying heart of the matter—which industry or company will win and which will lose by it. Winners and losers are picked all the time; the picking is the stuff of politics.

Perhaps Charles Reich would prefer that government refrain from all policies which discriminate among companies and industries, even those whose purposeful discriminations are hidden from public view. The problem with this approach, put simply, is that it would render the government incapable of doing much of anything. Laws and agency rulings need not specifically target winners and losers in order for their effects to be highly discriminatory. Because each industry and company has a distinct competitive position relative to all others—based on the mix of costs it bears and the markets it serves—any seemingly even-

6. C. Reich, *supra* note 4, at 196.

handed program is likely to affect it differently from others. Even something so apparently neutral as a tax credit for new capital investment favors industries and companies whose competitive success hinges on continually updating plant and equipment, relative to those that depend on the careful hiring and training of personnel or on the use of sophisticated marketing techniques. (Thus, the disparities noted above in effective rates of corporate income tax are due not so much to tax breaks targeted to particular industries as to differences in the ability of industries to take advantage of superficially neutral deductions and credits.) Most industry lobbyists, and not a few legislators and government officials, well understand this principle: *no tax, credit, or subsidy program, however neutral in appearance, is neutral in competitive effect.*

There is no way out. Even if we were to follow the pontifications of Milton Friedman and the rhetoric (but not the deeds) of Ronald Reagan, and to reduce the size of government, we would still be faced with all sorts of purposeful discriminations. They crop up even when deciding upon minimal “rules of the game”—for example, should copyright protection be extended to cover the circuitry etched on computer chips? Should coal slurry pipelines have “*eminent domain*” authority to run beneath railroad lines? Should a Japanese manufacturer of fiber-optic cable be allowed to sell its wares in the United States at a fraction of the cost of producing them in Japan?

But perhaps Charles Reich’s real concern is that any concerted effort to render more coherent our industrial policy would be doomed by the same special interests that have fashioned it in the first place. That is, any explicit recognition of the winners and losers inevitably associated with a particular policy, and any move toward a more comprehensive and centralized administration of such policies, would encourage more special pleadings and politicize the economy to an even greater extent—ultimately threatening the legitimacy of all governing institutions. This is a valid concern. But it seems to me that a stronger argument can be made for just the opposite hypothesis: that the *only* way to transform our present industrial policy from a “do-it-yourself” variety dominated by the most powerful companies and industries is by centralizing its administration and enhancing its visibility. Choices would still have to be made, of course, but at least they could then be informed by public debate. Indeed, it seems to me that such an open industrial policy would have a better chance of gaining broad public support than our presently covert one, precisely because the public would be more directly involved in creating it. The experience of other democratic industrialized nations, and our own history, provide some evidence for both

points of view, although I believe somewhat more evidence for the latter.

II. *Preservation of Liberty*

Charles Reich's second worry is that any further blurring of the distinction between the government and private corporations will threaten individual liberties. "[W]orkers' disability benefits and other government entitlements, their social lives, and even their political influence, will come under the expanded jurisdiction of corporate employers."⁷ As a result, workers would be more dependent on their companies, less free to change jobs or otherwise buck the "system."

Here again, Charles Reich expresses a valid concern, but it can only be understood and addressed once we distinguish between description and prescription. The underlying problem derives not from public-private border crossings, but from a political failure to acknowledge interpenetration and to structure it in such a way as to protect personal freedom.

To an increasing extent over the last fifteen years, social benefits to individuals have been channelled through the private sector. Government agencies now contract with private for-profit corporations to supply welfare services like transportation for the handicapped, day care and nursing homes (80 percent of which are now operated for profit, although the government pays two-thirds of their costs).⁸ Help also is provided indirectly through tax credits, vouchers (such as food stamps) and cash grants, whose recipients purchase goods and services directly from the private sector.

Perhaps the most dramatic growth has occurred in social services that are passed through the corporation to their employees, tax free. These include such benefits as health insurance, life insurance, retirement savings, child care, and personal counseling for marital, alcohol, drug, emotional, family, legal, and financial problems. Because employees do not pay taxes on these benefits, the government in effect pays a portion of their costs. In fiscal 1985, for example, the government will forego \$80.7 billion in revenues because employers' contributions to workers' pension accounts are not counted as income to the workers. The income earned by pension accounts also is exempt from taxation. In addition, the government will forego \$28.2 billion in revenues because employees need not count as income employer contributions to health insurance plans

7. *Id.* at 198.

8. N. GILBERT, CAPITALISM AND THE WELFARE STATE: DILEMMAS OF SOCIAL BENEVOLENCE 9 (1983).

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and direct reimbursement for medical care costs. All told, "tax expenditures" in the form of social benefits to employees will total \$116 billion.⁹

To get some idea of the pervasiveness of social services channelled through the private sector one has only to look closely at the way our society has organized institutional care. For example, it has been estimated that in the State of California, on any particular day, about 8 million people of the state's 19.5 million residents are under the care of some institution—in day care centers, schools, hospitals, prisons, old-age homes, and the like.¹⁰ This figure does not include the 2 million people enrolled in colleges and vocational and technical schools. Only a fraction of these institutions are directly financed *and* run by government—state or federal. Some institutions are financed by government but run privately. Some are run privately and financed in the first instance by companies or individuals, but government support nevertheless is critical: the institution may be deemed not-for-profit, in which case it does not pay taxes on its net revenues; the company or individual who purchases the services may be able to deduct the costs from its income; employees may get the services tax free. Under these different circumstances, where does public sphere end and private begin?

This channelling of social services through the private sector surely creates possibilities for abuse. Private providers may deliver services that are sub-standard. They may "skim the cream" by serving or insuring only those who have a relatively low risk of becoming particularly needy. They may discriminate on the basis of sex or race. They may condition delivery upon a recipient's willingness to conform his or her behavior to certain corporate standards.

Government is capable of these same abuses when it delivers social services directly, of course. But at least then, any unlawful discriminations or unconstitutional standards can readily be challenged in court. Charles Reich seems to be arguing that indirect social services represent a greater danger to individual liberties because they would be much more difficult to monitor and control. Precisely because they would be more pervasive, they would be more insidious. How could the courts effectively police the wide variety of forms which these services might take? When a person's livelihood is at stake, how could coercion be distinguished from acquiescence? And therefore how could we be certain that people would stand up for their rights?

I'm merely suggesting one line of argument. Charles Reich barely

9. Clark, *On the Fringe—1985 Could Be the Year Congress Zeroes in on Employee Benefits*, 16 NAT'L J. 1356, 1357 (1984).

10. Bell, *The Public Household—On "Fiscal Sociology" and the Liberal Society*, THE PUBLIC INTEREST, Fall 1974, at 29, 39.

hints at it. But the curious thing about this argument, quite apart from its failure to comprehend the extent of the public-private mix, is that it leaves out the “market” altogether. That is, the argument assumes that social services channelled through the private sector are just like social services delivered directly by the government, except that they take a slightly different route. This assumption is based on the obvious fact that companies extend such in-kind benefits to their employees because the government in effect pays part of their costs; if the benefits were not exempt from income taxes, employees presumably would prefer the cash. But the argument ignores the *public* justification for relying on the private sector: the belief that competition among providers—and the potent fear that unsatisfied beneficiaries will take their business elsewhere—will enhance quality and reduce costs. Theoretically, at least, there would be far less need for judicial intervention to protect beneficiaries under this sort of market-based system, simply because the beneficiaries would have more control over the providers.

But in order to make a system like this work as it should to enhance quality, reduce costs, *and* to protect individual liberties, government would need to structure carefully the *terms* of competition. For example, duly-elected employee representatives might be given initial responsibility for screening potential providers and negotiating alternative packages of benefits. Government might require that services be portable, so that employees can in effect carry them from job to job without losing accumulated benefits. Providers might be required to extend benefits to workers who are unemployed, in return for government-supplied vouchers. There would need to be rules against “cream skimming” and other forms of discrimination.

However the system is designed, it should be clear that the practical choice is not between public and private provision of services. It is between a rather ad-hoc “public-private” system whose growth has been stimulated largely by tax considerations, and which is open to a variety of abuses, and a public-private system specifically designed to foster competition and to protect individual liberties. The underlying lesson here is analogous to the previous one, drawn in connection with government advantages flowing to certain companies and industries. Some of the most important choices we face concern not *whether* government benefits are to be allocated, but *how* they are to be allocated. The boundaries already have been crossed; in some respects they never existed to begin with. And in order to begin making public choices about such allocations we need to enhance the visibility of this system of benefits, give it a greater degree of administrative integrity and coherence, and thereby render it more accountable.

III. *The Challenge to Politics*

Government legitimacy and personal liberty are two of the values that Charles Reich would place particularly high on his list of criteria for a society evincing "balance, harmony and health." I would agree. But he is somewhat less concerned than I am about economic growth and industrial evolution. Or rather, he worries that these more materialistic values may undermine the former, and that therefore we need some safeguards—like "social impact statements"—to remind us of these "other priorities." I am not sure what Charles Reich means by a "social impact statement," but if the Environmental Impact Statement is any guide its real meaning is apt to be found within lawsuits mounted by those who would seek to delay or block government action. Still, I am in favor of efforts designed to force policy-makers to think more broadly about the consequences of their decisions. Policies aimed relentlessly at promoting economic development to the exclusion of other social values would hardly improve our collective well-being.

Economic growth is not necessarily inconsistent with these other values. To the contrary, as I have argued elsewhere,¹¹ continued economic growth may be a necessary prerequisite to a more equitable distribution of wealth and income, more job security, and a greater degree of democratic participation in economic life. This is because it is probably easier to summon the political will for creating a more equitable and democratic society if those who already have a fairly comfortable existence—in particular, people comprising America's vast middle class—do not fear that their own standard of living will be eroded in the process. (One could, of course, conjure up historic examples of economic hardship so extreme that the middle classes join with the poor in expropriating the wealth of the rich, but this method for gaining a more equitable distribution of wealth seems somewhat unlikely in modern America.) These same aspects of what we understand to be "social justice" are coming to be prerequisites to continued economic growth. This is because groups who feel particularly burdened by economic change can mobilize politically to block or forestall change; their claims typically take the form of quotas, tariffs, restrictions on capital mobility, or subsidies to older companies and industries. It is also because the very organization of production is coming to depend on groups of citizens who are collectively committed to enhancing productivity and wealth.¹²

11. R. REICH, *THE NEXT AMERICAN FRONTIER* (1983).

12. The business press brims daily with examples of "quality circles," "quality-of-working life" groups, and other Japanese-style organizational innovations designed to enhance productivity. See, e.g., *American Labor Learns Japanese Production*, Wash. Post, June 24, 1984, at G5; *Companies Widen Worker Role in Decisions*, N.Y. Times, Jan. 15, 1984, at A1, col. 4.

In short, I believe that social justice and economic growth are bound up together. And for this reason it seems to me to be vitally important that we better understand the relationships between our economic policies and our social life. A more explicit industrial policy represents a first step. It might enable us to perceive the trade-offs lurking here—between, say, a particular pattern of economic growth and personal autonomy. It would allow us to ask “what *kind* of economic growth?” It would help us decide upon the pace and direction of economic growth. None of this is intended to suggest that we should politicize every major economic decision. The point is that most major economic decisions are by nature political, but the political dimension is often systematically obscured. This submergence of politics results in economic policies whose burdens and benefits are allocated in ways that may be felt to be unfair, or which may jeopardize fundamental freedoms.

The real difference between Charles Reich and me, I think, lies in Charles Reich’s assumption that we don’t already have an industrial policy. He thinks the borders are now relatively secure. He worries that I am anxious to overrun them with new and far more extensive forms of government largesse, and that I secretly trust large corporations to take on the job of transforming the economy with government’s help. But he is wrong on all counts. Our nation’s industrial policy is complex and pervasive. It is dominated by large corporations, but many other organized groups are also participating in it. It is altering our social and economic life in countless ways. It has profound implications for government legitimacy, personal liberty, economic growth, and other values. To ignore it, or to pretend that it is of little consequence, is to give up on the possibility for democratic deliberation and control.

Charles Reich’s observation almost twenty years ago, with regard to the mythology of formal legal processes, has even greater force today with regard to the mythology of neutral public policies:

It [is a myth which] prevents us from seeing resource allocation as a process by which some are punished and others rewarded for reasons which have no relation to objective merits but have relation only to government policy. It preserves the appearance of the rule of law, making it seem that the immensely important allocation and planning process is being carried out at all times subject to fair and equitable guiding principles.¹³

13. C. Reich, *The Law of the Planned Society*, 75 YALE L.J. 1227, 1237 (1966).